

Message Text

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PAGE 01 OECD P 29494 01 OF 02 091829Z

46

ACTION EUR-12

INFO OCT-01 ISO-00 EURE-00 AID-05 CEA-01 CIAE-00 COME-00

EB-07 EA-06 FRB-01 INR-05 IO-10 NEA-06 NSAE-00 RSC-01

OPIC-03 SP-02 TRSE-00 CIEP-01 LAB-04 SIL-01 SWF-01

OMB-01 STR-01 L-02 SS-15 NSC-05 AGR-05 H-01 PRS-01

PA-01 USIA-06 FEAE-00 INT-05 /110 W

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O P 091801Z DEC 74

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E.O. 11652: N/A

TAGS: ECON, OECD

SUBJECT: EDRC ANNUAL REVIEW OF ITALY, DEC. 12

REF: OECD DOC EDR(74)34

1. SUMMARY: DOCUMENTATION FOR ITALIAN REVIEW STILL NOT RELEASED BUT MISSION HAS OBTAINED ZEROX COPIES OF FINAL DRAFT WHICH HAVE BEEN HANDCARRIED TO WARREN CLARK, EUR/RPE AND EXPRESS AIRMAILED TO ROME ON DECEMBER 6. MAIN ISSUES FOR DISCUSSION AT ANNUAL REVIEW WILL BE SHORT TERM OUTLOOK AND POLICY MEASURES FOR DEALING WITH DEPRESSED DEMAND, EXPECTED HIGH UNEMPLOYMENT, CONTINUED RAPID RISE IN PRICES, AND CONTINUING LARGE EXTERNAL DEFICIT IN 1975. MISSION INVITES COMMENTS AND QUESTIONS FROM DEPT AND EMBASSY, AND WOULD AS USUAL WELCOME PARTICIPATION AT ANNUAL REVIEW BY EMBASSY ROME. END SUMMARY

2. OUTLOOK FOR 1975: SECRETARIAT DOCUMENT REFLECTS COM-
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PAGE 02 OECD P 29494 01 OF 02 091829Z

BINED SENSE OF PRAYER AND DESPAIR FOR ITALIAN ECONOMIC

PROSPECTS IN 1975. FORECASTS INDICATE LOW LEVEL OF DOMESTIC DEMAND, LARGE MARGIN OF UNUSED PRODUCTION CAPACITY, AND UNEMPLOYMENT RISING TO 4.5 - 5 PERCENT BY END OF 1975. HOWEVER, SECRETARIAT IS NOT OPTIMISTIC THAT THESE DEVELOPMENTS WILL SLOW DOWN RATE OF INFLATION SIGNIFICANTLY OR HAVE SUBSTANTIAL LIMITING EFFECT ON FOREIGN TRADE DEFICIT. (THIS CONTRADICTED BY SECRETARIAT'S PROJECTIONS: SEE PARA 6).

3. GROWTH OF OUTPUT AND DEMAND: SECRETARIAT SEES ITALIAN ECONOMY ENTERING RECESSIONARY PHASE IN LATE 1974 AND CONTINUING THROUGH 1975. WEAKEST COMPONENT OF DOMESTIC DEMAND WILL BE GROSS FIXED CAPITAL FORMATION BUT PRIVATE CONSUMPTION WILL ALSO BE FLAT. SECRETARIAT SEES SOME HOPE THAT EXTERNAL DEMAND MAY SOMEWHAT OFFSET WEAK INTERNAL POSITION, BUT NOTES THAT ITALIAN EXPORTS NOT WELL PLACED TO INCREASE MARKET SHARES AT TIME OF GENERALIZED SLACK.

4. OUTLOOK FOR PRICES: SECRETARIAT SEES SLOWDOWN IN RATE OF INCREASE IN PRICES BASED ON ASSUMPTIONS THAT (A) OIL AND RAW MATERIAL PRICE RISES ARE LARGELY OVER, (B) WEAK DOMESTIC DEMAND WILL MAKE PRICE PASS THROUGH DIFFICULT FOR COMPANIES, AND (C) CONSIDERABLE UNEMPLOYMENT (AND ABSENCE OF MAJOR COLLECTIVE BARGAINING NEGOTIATIONS) WILL DISCOURAGE WAGE INCREASES. HOWEVER, SECRETARIAT RECOGNIZES POSSIBILITY THAT 1975 MIGHT ALSO BRING RUNAWAY INFLATION SINCE "INFLATION HAS NOW REACHED SUCH PROPORTIONS THAT IT HAS BECOME SELF-PERPETUATING VIA A PRICE/WAGE SPIRAL WHICH NO LONGER HAS MORE THAN A TENUOUS RELATIONSHIP WITH THE DOMESTIC DEMAND POSITION."

5. POLICY MEASURES: SECRETARIAT CONSIDERS IT ESSENTIAL FOR ITALIAN AUTHORITIES TO MAINTAIN RESTRICTIVE STANCE IN FACE OF DOMESTIC INFLATION AND BALANCE OF PAYMENTS DISEQUILIBRIUM (ALTHOUGH RECOGNIZING THAT INFLATION MAY NOT BE AFFECTED BY DOMESTIC DEMAND POSITION--SEE ABOVE--AND THAT SCOPE FOR INCREASED WORLD MARKET SHARES IS LIMITED). SECRETARIAT SIMULTANEOUSLY URGES MEASURES TO OFFSET ADVERSE EFFECTS OF RESTRICTIVE POLICIES ON EMPLOY-LIMITED OFFICIAL USE

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PAGE 03 OECD P 29494 01 OF 02 091829Z

MENT AND INVESTMENT, SUGGESTING SHORTER WORKING HOURS TO ENSURE AT LEAST PARTIAL EMPLOYMENT, AND POSSIBLE GUARANTEED MINIMUM INCOMES SCHEME TO BE FINANCED, PERHAPS, BY SURTAX ON HIGHEST INCOMES. FOR INVESTMENT, SECRETARIAT PROPOSES RELAXATION OF CREDIT RESTRAINTS ON HOUSING AND NON-RESIDENTIAL CONSTRUCTION, AND SOME KIND OF SUPPORTING ACTION FOR PUBLIC WORKS PROJECTS. (COMMENT: SUCH MEASURES, UNLESS CAREFULLY DESIGNED, COULD GIVE FURTHER

STIMULUS TO INFLATION.) SECRETARIAT WOULD LIKE TO SEE
NEW TEMPORARY PRICE FREEZE, ALTHOUGH RECOGNIZING THAT
EARLIER EFFORTS IN THIS FIELD WERE UNSUCCESSFUL. ON
INCOMES SIDE, SECRETARIAT SEES NO CHANCE OF IMPLEMENTING
AN INCOMES POLICY UNDER PRESENT SITUATION OF "PERMANENT
PROTEST AGAINST THE SYSTEM". (COMMENT: ABOVE IS EXAMPLE
OF GREAT UNCERTAINTY REFLECTED BY SECRETARIAT IN REFDOC
REGARDING WHAT ITALY CAN OR SHOULD DO TO RESOLVE ITS
PROBLEMS.)

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PAGE 01 OECD P 29494 02 OF 02 091811Z

46

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OMB-01 STR-01 L-02 SS-15 NSC-05 AGR-05 H-01 PRS-01

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6. BALANCE OF PAYMENTS: SECRETARIAT SEES HOPE FOR SOME
GRADUAL IMPROVEMENT IN BALANCE OF PAYMENTS IN RESPONSE TO
REDUCED DOMESTIC DEMAND AND SOME EXPANSION OF EXPORT
MARKETS. REFDOC POSES POSSIBILITY ITALY MAY BE ABLE
TO ELIMINATE NON-OIL DEFICIT COMPLETELY IN 1975, BRING-

ING CURRENT ACCOUNT DEFICIT DOWN TO \$5-6 BILLION (FROM ESTIMATED \$8.5 BILLION IN 1974). HOWEVER, PRINCIPAL REPAYMENTS FOR PAST BORROWINGS WILL PLACE HEAVY BURDEN ON CAPITAL ACCOUNT. THUS FORESEE NEED FOR ITALY TO HAVE FURTHER RECOURSE TO FOREIGN BORROWING NEXT YEAR. SECRETARIAT ASSUMES THAT "THE VALUE OF THE LIRA WILL REMAIN MORE OR LESS UNCHANGED".

7. MISSION INTENDS TO QUESTION SEEMING INTERNAL INCONSISTENCIES IN REFDOP POLICY PRESCRIPTIONS, (E.G., TEMPORARY PRICE FREEZE SUGGESTION IN FACE OF POOR PAST LIMITED OFFICIAL USE

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PAGE 02 OECD P 29494 02 OF 02 091811Z

EXPERIENCE; GUARANTEED MINIMUM INCOME SCHEME IDEA WHICH WOULD FURTHER COMPLICATE BUDGETARY PROBLEMS; REFERENCE TO WAGE/PRICE SPIRAL AFTER NOTING FAVORABLE OUTLOOK FOR WAGES AT TIME OF GROWING UNEMPLOYMENT.) MOSTLY, HOWEVER, WE INTEND TO PRESS ITALIAN DELEGATION FOR ITS VIEWS OF HOW AUTHORITIES EXPECT TO TACKLE ITALY'S MULTIFARIOUS PROBLEMS INCLUDING HOW MONETARY, FISCAL AND EXCHANGE RATE POLICIES LIKELY TO DEVELOP, WHAT ARE ITALY'S EXPORT PROSPECTS VIS-A-VIS OIL PRODUCING COUNTRIES AND HOW BALANCE OF PAYMENTS DEFICIT IN 1975 WILL BE FINANCED. FURTHER SPECIFIC COMMENTS OR QUESTIONS FROM DEPARTMENT AND EMBASSY ROME WOULD BE WELCOME. AS IN PAST, MISSION WOULD BE GLAD TO HAVE EMBASSY ROME PARTICIPATION AT DEC. 12 ANNUAL REVIEW.
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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC DEVELOPMENT, COMMITTEES, ANNUAL REPORTS
Control Number: n/a
Copy: SINGLE
Draft Date: 09 DEC 1974
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: golinofr
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1974OECDP29494
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D740356-0973
From: OECD PARIS
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1974/newtext/t19741250/aaaabqqo.tel
Line Count: 201
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION EUR
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators:
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: OECD DOC EDR(74)34
Review Action: RELEASED, APPROVED
Review Authority: golinofr
Review Comment: n/a
Review Content Flags:
Review Date: 08 APR 2002
Review Event:
Review Exemptions: n/a
Review History: RELEASED <08 APR 2002 by elyme>; APPROVED <15-Aug-2002 by golinofr>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: EDRC ANNUAL REVIEW OF ITALY, DEC. 12
TAGS: ECON, IT, OECD, EDRC
To: STATE ROME
Type: TE
Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005